



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

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| <u>Date</u> | = |
| <u>Company</u> | = |
| <u>Trust</u> | = |
| <u>Director</u> | = |
| <u>Charity</u> | = |
| <u>X</u> | = |

Dear :

This is in response to your letter dated May 8, 2013, in which you requested certain rulings with respect to I.R.C. §§ 4943.

Background:

You are a non-profit organization described in § 501(c)(3) and classified as a private foundation under § 509(a). You were founded on Date when you were initially funded with shares of stock in Company. At the time of this transfer your shares represented over 5.5 percent of the shares in Company. These shares were transferred to you from Trust and represent your only assets. Your founders, for whom you are named, and who are also two of your directors, are the trustees, beneficiaries, and settlors of Trust. Throughout the time that you have owned shares in Company, these disqualified persons have together held more than 35 percent of the shares of Company.

Over the initial five years that you owned these shares you divested yourself of certain shares in order to fund your charitable programs. At the end of those five years you owned over X percent of the shares in Company. At this time the disqualified persons listed above continued to hold over 35 percent of the shares in Company.

Shortly after the end of your initial five years, your founders attempted to take Company private by buying out shareholders of Company other than you. In the process of purchasing the other shares another company stepped in to merge with Company and talks regarding the details of this merger, as well as the financing for such a buyout, took several months. During this time the price of Company's stock was highly volatile and all of your directors had inside information on the merger and were advised that they could not sell shares in Company held by you without

risking SEC sanctions. At the end of the merger you still held over X percent of the new company and your founders still held over thirty-five percent of shares in that company.

After merger talks had begun, and after the end of the tax year in which the initial five year holding period concluded, you discovered that you had excess business holdings. You propose to correct your excess business holdings by donating the number of shares necessary to bring your portion of the shares to less than two percent of the overall shares to public charities exempt from tax and recognized as described in § 501(c)(3). One of the proposed donees of your shares is Charity. One of your founders serves as one of sixteen directors of Charity, while the other founder serves as one of twelve advisory board members for Charity. Also, one of your advisory board members serves as a non-voting secretary for the board of Charity.

Charity provides scholarships to students who have attended a state public school for the four years immediately prior to high school graduation, who attain a cumulative GPA of 2.0 or higher, and who are eligible for Federal Financial aid and demonstrate need. Your shares that are given to Charity would go toward providing for a scholarship fund for a student that not only met the criteria above, but who also meet the criteria for "deferred action status" as used by the Secretary of Homeland Security in her June 15, 2012 memorandum regarding the exercise of prosecutorial discretion with respect to individuals who came to the United States as children. These criteria require that the applicant (1) not currently have legal status in the United States; (2) have arrived in the United States before they attained sixteen years of age; (3) had five years of continuous residency in the United States prior to June 15, 2012; (4) were present in the United States on June 15, 2012; (5) are currently in school, have graduated from high school, have obtained a general equivalence degree, or are honorable discharged veterans of the Coast Guard or Armed Forces of the United States; (6) have no felony convictions; and (7) have not attained thirty years of age. The board of Charity will exercise ultimate control over which applicant meeting those criteria is selected for the scholarship and it will have ultimate control over the sell or investment of the shares donated to it.

Ruling Requested:

Contributions to unrelated public charities who are recognized as exempt under § 501(c)(3) of the number of shares sufficient to bring your remaining shares to two percent or lower ownership interest will render your retained shares permitted holdings under § 4943.

Law:

I.R.C. § 501(c)(3) provides that organizations may be exempted from tax if they are organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes and "no part of the net earnings of which inures to the benefit of any private shareholder or individual."

I.R.C. § 507(d)(2) provides that a substantial contributor means any person who contributed or bequeathed an aggregate amount of more than \$5,000 to the private foundation, if such amount is more than two percent of the total contributions and bequests received by the foundation.

I.R.C. § 4943(c)(1) defines "excess business holdings" as the amount of stock or other interest in the enterprise which the foundation would have to dispose of to a person other than a disqualified person in order for the remaining holdings of the foundation in such enterprise to be permitted holdings.

I.R.C. § 4943(c)(2)(A) defines "permitted holdings" as twenty percent of the voting stock of any corporation reduced by the percentage of stock owned by all disqualified persons.

I.R.C. § 4943(c)(2)(B) provides that if (i) the private foundation and all disqualified persons together do not own more than 35 percent of the voting stock of an incorporated business enterprise, and (ii) it is established to the satisfaction of the Secretary that effective control of the corporation is in one or more persons who are not disqualified persons with respect to the foundation, then subparagraph (A) shall be applied by substituting 35 percent for 20 percent.

I.R.C. § 4943(c)(2)(C) provides that a private foundation shall not be treated as having excess business holdings in any corporation in which it owns not more than two percent of the voting stock and not more than two percent in value of all outstanding shares of all classes of stock.

I.R.C. § 4946(a)(1) provides that a "disqualified person," with respect to a private foundation, includes a substantial contributor, as defined under section 507(d)(2); a foundation director, trustee, or officer; and any spouse, ancestor, child, grandchild, great grandchild, and any spouse of a child, grandchild, or great grandchild of that contributor, director, or officer.

Treas. Reg. § 53.4943-2(a)(1)(iv) states that if a private foundation disposes of an interest in a business but imposes any material restrictions or conditions that prevent the transferee from freely and effectively using or disposing of the transferred interest, then the transferor foundation will be treated as owning such interest until all such restrictions or conditions are eliminated.

Treas. Reg. § 53.4943-2(b)(1)(i) provides that except as otherwise provided in §§ 4943(c)(2) and (4), the permitted holdings of any private foundation in an incorporated business enterprise are:

(A) 20 percent of the voting stock in such enterprise reduced (but not below zero) by

(B) The percentage of voting stock in such enterprise actually or constructively owned by all disqualified persons.

Treas. Reg. § 53.4943-3(b)(3)(i) provides that except as provided in § 4943(c)(4), paragraph (b)(1) of this section shall be applied by substituting 35 percent for 20 percent if:

(A) The private foundation and all disqualified persons together do not hold, actually or constructively, more than 35 percent of the voting stock in the business enterprise, and

(B) The foundation establishes to the satisfaction of the Commissioner that effective control (as defined in paragraph (b)(3)(ii) of this section) of the business enterprise is in one or more persons (other than the foundation itself) who are not disqualified persons.

Analysis:

As a private foundation, under § 4943 you are subject to an excise tax on your excess business holdings. Under § 4943(c)(2)(A), your permitted holdings in Corporation are limited to 20 percent of the voting stock, less the percentage of voting stock owned by all disqualified persons. Under § 4943(c)(2)(B) and § 53.4943-3(b)(3)(i), your permitted levels of voting stock

in Company may be raised to 35 percent, if you demonstrate that effective control of the business enterprise is in one or more persons, other than the foundation itself, who are not disqualified persons. Under § 4946(a)(1) a disqualified person means, with respect to a private foundation, a person who is a substantial contributor to the foundation, a foundation manager, a member of the family of any individual described in above. Section 507(d)(2)(A) defines a substantial contributor as any person who contributed or bequeathed an aggregated amount of more than \$5,000 to a private foundation, if such amount is more than two percent of the total contributions and bequests received by the foundation before the close of the taxable year of the foundation in which the contribution or bequest is received by the foundation from such person. Here, you have stated that the others owning shares in Company are disqualified persons since they are foundation managers, substantial contributors, and family members of the above listed individuals.

You currently hold over X percent of the stock in Company while you have represented that disqualified persons as to you own over 35 percent of the stocks of Company. Additionally, you have represented that disqualified persons as to you effectively control Company. These facts mean that you have excess business holdings under § 4943(c). Section 4943(c)(2)(C), provides however, that if a private foundation holds less than two percent of the voting stock and less than two percent in value of all of the outstanding shares, then these shares will be considered de minimis, thus would not be considered excess business holdings, regardless of the overall percentage held by the private foundation and its disqualified persons. You propose to dispose of your holdings in Company to the extent that your holdings exceed two percent of the voting stock and the overall value of all stocks issued. You will dispose of these stocks to organizations described in § 501(c)(3) and classified as public charities. Some of your stocks will go to Charity. These stocks will be used to create a fund to provide scholarships to individuals who meet specific criteria beyond those required for Charity's usual scholarship. Additionally, one of your directors is also a director of Charity while a second of your directors is on the advisory board for Charity.

Section 53.4943-2(a)(1)(iv) states, however, that if a private foundation disposes of an interest in a business but imposes any material restrictions or conditions that prevent the transferee from freely and effectively using or disposing of the transferred interest, then the transferor foundation will be treated as owning such interest until all such restrictions or conditions are eliminated. The additional criteria you place on the scholarships issued by Charity through your fund and the minority status of your directors on the board of Charity do not constitute material restrictions preventing Charity from freely and effectively using or disposing of the transferred interest. While the regulations do not provide further information as to what would constitute restrictions preventing the free and effective use or disposition of transferred interest, the restrictions you have placed on the separate fund do not involve the use or disposition of the transferred interest. Charity can choose to sell those interests and reinvest or it can choose to hold that interest and pay the scholarships from dividends of such interest. Your additional criteria also do not limit the organization from using such funds to further its charitable purpose of providing funds for education. Additionally, your directors that have managerial and advisory powers over Charity do not hold enough of such power to independently, or together, determine the disposition of such interests. As such, your interest transferred to Charity will be considered as transferred for purposes of § 53.4943-2(a)(1)(iv). Since the amounts transferred will be considered to no longer belong to you, you will have less than two percent of the shares in Company so long as you transfer a sufficient amount. Your remaining shares will constitute permitted holdings as long as they remain below two percent of the voting stock and two percent in value of all outstanding shares.

Ruling:

Contributions to unrelated public charities who are recognized as exempt under § 501(c)(3) of the number of shares sufficient to bring your remaining shares to two percent or lower ownership interest will render your retained shares permitted holdings under § 4943.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Specifically, this ruling does not address any private benefit concerns that may be present with your operations. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Ronald Shoemaker
Manager, Exempt Organizations
Technical Group 2

Enclosure
Notice 437